



Federal Home Loan Bank of Indianapolis

Letters of Credit



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◆ Letter of Credit

- Irrevocable commitment of FHLB to pay regardless of what happens with the underlying transaction
- If drawn, payment is made to the trustee as LC beneficiary
- Used to credit enhance bonds or other transactions to a AAA rating

Uses for Letters of Credit



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- ◆ Housing finance or commercial economic development that benefit low- and moderate- income families or are located in low- and moderate-income neighborhoods
- ◆ Purchase mortgage loans or servicing rights w/ LC as a performance bond
- ◆ Collateralization of public unit deposits
- ◆ Member interest rate swaps and asset-liability management
- ◆ Housing Finance Authorities (Housing Associates) may also use LCs

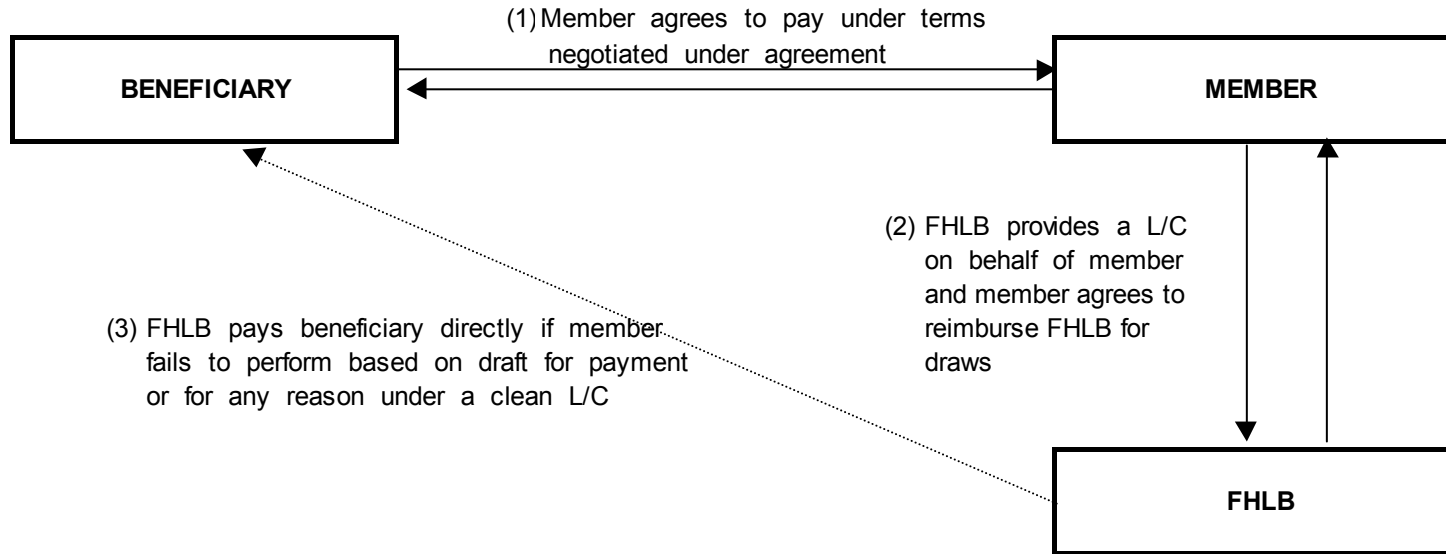
Types of Letters of Credit



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- ◆ Standby Letter of Credit (SLC)
 - Only drawn upon in case underlying transaction does not perform
- ◆ Direct Pay
 - Bond trustee draws directly on FHLBI for principal and interest payments.

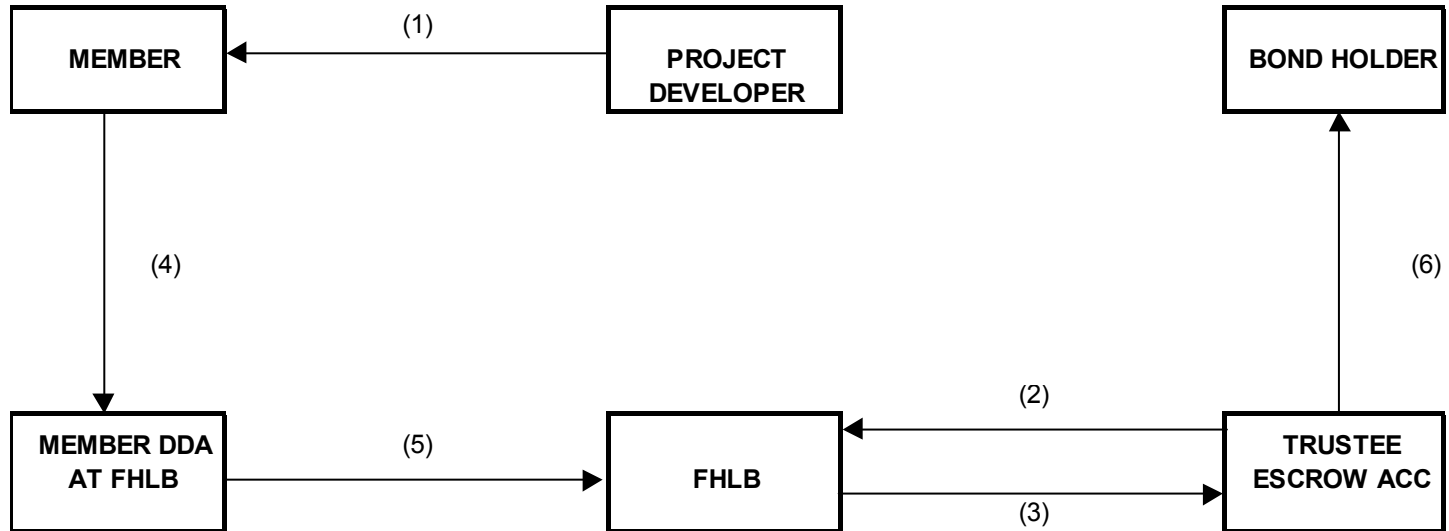
STANDBY LETTER OF CREDIT STRUCTURE



- (1) The member negotiates terms under which payments will be made for a specific transaction. In order to enhance credit quality/performance under the agreement, a letter of credit may be requested by the beneficiary.
- (2) The member may obtain a FHLB Standby Letter of Credit as direct support of its ability to perform.
- (3) Standby letters of credit are generally issued on a "Clean" basis, meaning that payouts are made under the submission of a properly documented draft.

******* Under normal circumstances, a standby letter of credit is not expected to be drawn upon.**

DIRECT PAY LETTER OF CREDIT STRUCTURE AND CASH FLOW



- (1) Project developer/owner makes regularly scheduled principal and interest payments.
- (2) One day prior to the payment date a draft against the L/C is presented to the FHLB by the Trustee.
- (3) On the payment date the FHLB will forward funds to the Trustee.
- (4) The member funds a demand deposit account with the FHLB from project developer payments.
- (5) The FHLB will debit the members account for the payment amount.
- (6) On the due date the Trustee will apply scheduled payments.

******Under the Direct Pay Letter of Credit structure, regularly scheduled interest payments in addition to unscheduled paydowns or putbacks are made by the FHLB to the Trustee.**

FHLBI Letter of Credit Fees



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- ◆ Inexpensive way to fund housing or economic development at “AAA” credit rates
- ◆ Annual fee of .37% of LC face amount plus administrative draw fees
- ◆ Annual fee of .20% of LC face amount plus administrative draw fees, if CIP eligible

Accessibility of FHLB L/C's



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- ◆ General Member credit requirements
 - Collateral, stock, borrowing limitations
- ◆ Application Submission
- ◆ Documentation requirements
 - App, Confirmation, Reimbursement Agreement, others as required
- ◆ CIP Eligibility
 - CIP application subject to Community Investment Div. approval

Benefits of FHLB L/C's



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- ◆ AAA Rating of FHLBank by S & P
- ◆ Increased marketability
- ◆ Facilitate lower interest rates/cost of debt
- ◆ Competitive fees
- ◆ Utilizes the efficient collateralization procedures of the FHLBanks

Legal Issue: IRS Code 149(b)



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- ◆ Whether an FHLB LC constitutes a guarantee of the U.S. Treasury and thereby invokes the 149 “double-dip” provision
- ◆ Effectively limits LC use only to multifamily housing when tax exempt bond financing is used
- ◆ Bond counsels reluctant to issue favorable opinions for tax-exempt commercial and economic development



- ◆ FHLBanks funding costs of IRS Private Letter Ruling (PLR)
- ◆ Submitted to IRS in April 2002



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- ◆ FHLBanks should be treated as private financial institutions and not instrumentalities for purposes of IRS Code 149(b)
- ◆ No federal funds or taxpayer dollars are used in FHLBank's operations (no "double-dipping" of taxpayer support occurs)
- ◆ FHLBank LCs should receive same treatment as Freddie, Fannie and Farm Credit Banks

Importance of PLR



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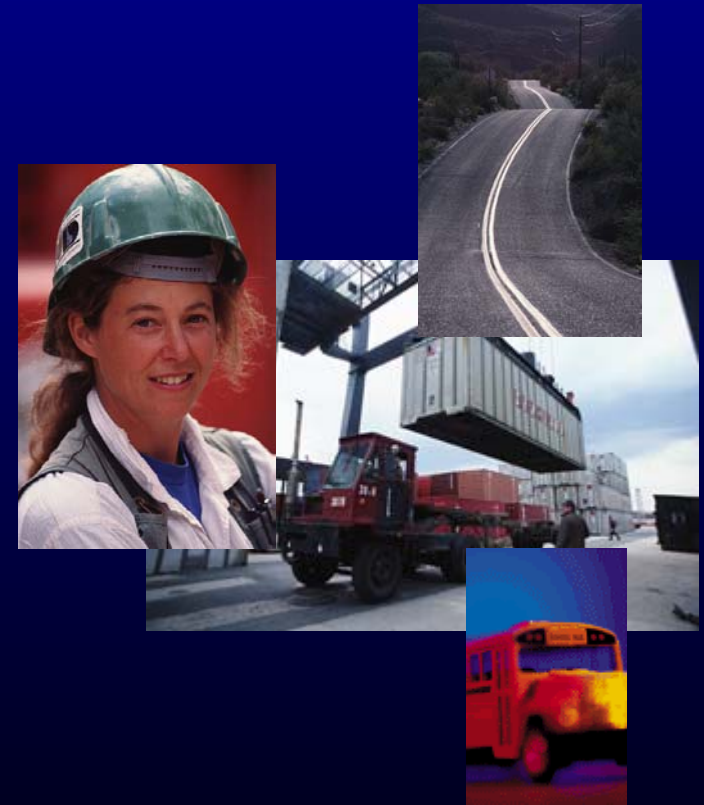
- ◆ Clarifies law so that bond counsels will issue opinions
- ◆ Enables tax-exempt municipal bonds with FHLBank LC credit enhancement for economic development to go forward
- ◆ Provides vehicles for community bank members to participate in municipal bond finance

Examples of economic development projects



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- ◆ Infrastructure improvements
 - Sidewalks, streets
- ◆ Public facilities
 - Libraries, correctional facilities
- ◆ Schools
- ◆ Manufacturing facilities



Current Status



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- ◆ Currently under review of IRS, no indication of outcome or timeframe
- ◆ If PLR is withdrawn, FHFB supports resolving the issue legislatively

